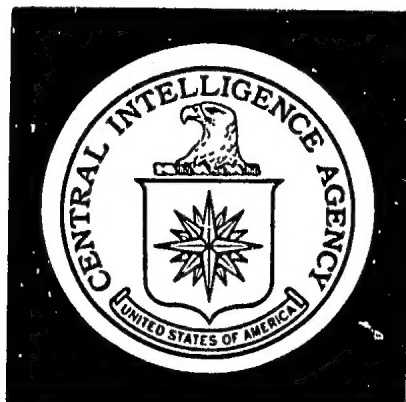


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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

Bolivia: Economic Implications of the Military Takeover

Secret

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CENTRAL INTELLIGENCE AGENCY
 Directorate of Intelligence
 30 September 1969

INTELLIGENCE MEMORANDUM

Bolivia:
Economic Implications of the Military Takeover

Introduction

The military takeover in Bolivia on 26 September will not necessarily end the political instability revived by President Barrientos's death and the threats to economic development that it generated. General Alfredo Ovando Candia (the leader of the new government) and other aspiring leaders appear to lack the popular support and political agility needed to continue Barrientos's policies, even if they wanted to. Those policies brought a period of reasonably satisfactory economic growth and financial stability. Barrientos's immediate successor adopted a more permissive labor policy, however, and seemed to favor popular but economically disruptive "revolutionary" changes, including moves against foreign investors.

The new regime's economic program is not yet clear. Although a recent Ovando speech condemning "Yankee imperialism" and the "occupation of the country" indicates a strongly nationalistic position, and his first act as president was to invalidate the Petroleum Code, [redacted]

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[redacted] he will not nationalize foreign firms but rather will negotiate greater government participation in resource development. It is probable, however, that the new government will respond more to political expediency than to economic considerations. This conceivably could lead to nationalization of the

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Bolivian Gulf Oil Company. But Ovando probably would try to avoid, at least initially, a confrontation with the United States similar to that provoked by Peru, because of Bolivia's dependence on foreign capital. This memorandum discusses the state of the Bolivian economy and the possible direction and consequences of the new government's economic policy.

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1. Except for Haiti, Bolivia is the poorest and most backward country in Latin America. The per capita income of its 4 million people is only \$230. Although it has important mineral and petroleum resources, development has been inhibited by inhospitable terrain, inadequate transportation, a shortage of managerial and technical skills, the small domestic market, [redacted] and revolutionary disturbances. Even more important, perhaps, has been the lack of domestic capital resources and the periodically unfavorable climate for foreign investment. 25X6

2. The 1952 revolution, which brought the National Revolutionary Movement (MNR) to power for twelve years, markedly altered Bolivian society and politics and drew many people into national life for the first time. It also brought the country to the brink of economic disaster. Nationalizing the large tin mines -- the major source of taxes and export earnings -- and hasty land redistribution resulted in dwindling production and raging inflation. A harsh stabilization program in the late 1950's brought inflation under control, and the economy grew fairly rapidly in the early 1960's, thanks to rising export prices, increased private foreign investment, and large inflows of foreign aid. The MNR nevertheless lost support because it could not meet the demands of organized labor and other groups. Increasing discord in the government and rivalries within opposition groups fragmented almost every political party. By the time a junta led by Barrientos (then the air force commander) assumed power in November 1964, the military was the only force capable of providing political and economic order.

3. Barrientos's popularity permitted him to pursue pragmatic economic policies. Although committed to the reformist ideals of the 1952 revolution, his government dealt firmly with insurrection and began to attack economic problems. Near-anarchy in the labor movement (which was and still is dominated by the extreme left) and a threatened nationwide strike in May 1965 brought strong government countermeasures. Military occupation of the tin mines and the exile of leftist labor leaders

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permitted implementation of reforms that forced the mines to operate at a profit for the first time since the early 1950's. After Barrientos's election in 1966, the government kept a tight rein on wages, public spending, and credit and kept inflation in check (see Table 1). Because of a relatively high investment level (about 17 percent of GNP in 1968), economic growth averaged 5 percent annually -- or 3½ percent per capita -- during 1967-68. Although foreign aid remained important, domestic savings financed about two-thirds of investment in 1967-68, compared with one-third in 1960. Export earnings finally recovered to the 1951 level in 1966 and have since increased further.

Table 1

Economic Indicators

| | <u>Annual Percentage Increase</u> | | | | | |
|--|-----------------------------------|----------------------------|-------------|-------------|-------------|---------------------------|
| | <u>1952-60 Average</u> | <u>1961-64 Average</u> | <u>1965</u> | <u>1966</u> | <u>1967</u> | <u>1968 Estimated</u> |
| Cost of living | 64 | 5½ | 2½ | 7 | 7½ | 6 |
| Gross domestic product in real terms | - ½ | 5 | 4 | 6½ | 5½ | 4½ |
| Gross domestic investment | N.A. | 10½ | 20½ | 6 | 7 | 18 |
| Exports (f.o.b.) | -9 | 14 | 17 | 16½ | 13½ | 5½ |

4. Recognizing that outside capital was badly needed to develop Bolivia's resources, Barrientos moderated nationalistic opposition to foreign investment. Liberal tax and amortization arrangements prompted increased foreign investment during 1965-67 in medium-sized mines and joint ventures with COMIBOL -- the state mining enterprise that holds the largest ore deposits. However, weakening mineral prices and legislation in late 1967 requiring COMIBOL to retain 51 percent control in joint ventures

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combined to discourage foreign investment. In early 1969, Bolivian Gulf's oil operation still was the largest foreign investment, and its plan to exploit a large gas deposit was the most promising development effort.

Policy Changes since Barrientos's Death

5. Barrientos's death in a helicopter crash in April 1969 left the nation with a weak and divided leadership. Upon assuming the presidency, Siles (the former Vice President) began maneuvers designed to win popular support and forestall an expected coup by General Ovando, the armed forces commander and Barrientos's presumed successor. On 29 August, Siles approved pay increases for the miners -- still a major potential source of political power -- that probably will raise tin production costs. Bolivian tin already is barely competitive in world markets.

6. Moves against foreign enterprises also were politically attractive. Two months after taking office, President Siles issued a decree turning over all unleased oil-bearing ground to YPFB, the state oil company. He stressed that this "revolutionary" measure marked a "return to nationalization of petroleum." His replacement of YPFB's highly regarded president with a left-leaning nationalist was a further retreat from Barrientos's policy and already has seriously impaired its cooperative relationship with Bolivian Gulf.

7. Congressmen also began to get into the act. By objecting to the award of the construction contract to Williams Brothers, a US firm having a 9 percent interest in Bolivian Gulf, a congressional commission temporarily jeopardized a \$23 million World Bank loan to YPFB and Bolivian Gulf for a gas pipeline to the Argentine border. Moreover, in a "preliminary" vote on 22 August the Senate called for uncompensated nationalization of all natural gasfields. Although President Siles and General Ovando privately voiced opposition to the bill, neither did so publicly. In what may be only a temporary compromise on the nationalization issue, Bolivian Gulf has agreed to supply YPFB with 20 million cubic feet of gas daily at zero wellhead cost.

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Further Possible Changes

8. Although Ovando may claim economic problems as partial justification for the coup, there is no indication that he has any deep understanding of them. In his infrequent public statements on such subjects, he has stressed the need for heavy industry in terms more demagogic than economic. Ovando has told US officials that he would follow Barrientos's program, and would revise the 1956 Petroleum Code in Bolivia's favor but would not nationalize foreign companies. Few observers believe, however, that he will sacrifice short-term political goals to economic requirements. Ovando, like Siles, lacks the popular support to rule in the Barrientos manner. He has little support among the Aymara Indian peasants around La Paz and his popularity with the Quechua Indians in the Cochabamba area is slipping. Foreign investors have little reason to be sanguine regarding his willingness to use nationalization as a political weapon.

9. Although nationalism has focused on the petroleum industry thus far, foreign mining interests (mainly US) offer another target. The liberal 1965 mining code attracted investments by several US firms, the most important of which is the Matilde Mining Corporation -- a subsidiary of Phillips Brothers and the US Steel Corporation. After investing \$12 million, this firm started producing zinc and other minerals in April 1969; by 1970 it should be paying royalties to the government of \$2 million annually. Another recently established US enterprise, *Sociedad Lipea Minera e Industrial* (SOLMIN), is the principal sulfur producer. Political moves against such companies also would further discourage exploitation of other mineral deposits such as the Mutun iron fields, a 40 billion ton deposit of high-grade ore -- 10 percent of known world reserves -- that has not been tapped so far because of its remote location and high silica content.

10. To win popular support, the new government also might call for redistribution of land in Santa Cruz Department, in eastern Bolivia. Relatively small commercial farms established in the area by Bolivian citizens and Asiatic immigrants with government encouragement have been the one success story of Bolivian agriculture in the last decade.

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But overcrowding of peasants on subsistence plots has made these farms a new target for "reform." Their break-up would materially reduce commercial production of such products as rice, cotton, and sugar.

Importance of the Petroleum Issue

11. Because it is presently the major force for expansion, the petroleum industry is important to the Bolivian economy. During 1955-65, when YPFB was the main producer, crude oil output stagnated at about 3 million barrels annually -- little more than domestic requirements. Since 1965, when Bolivian Gulf extended the trans-Andean pipeline to its Santa Cruz oilfields, output has risen to about 15 million barrels annually. Crude oil made up 15 percent of exports in 1968, compared with one-half of one percent in 1965. Growing exports of oil, zinc, silver, and copper have helped considerably to reduce dependence on tin exports (see Table 2). Oil exports could be doubled if two pumping stations were added to the pipeline and Chile allowed additional storage capacity at Arica, the line's terminus. Bolivian Gulf also has begun a joint exploration effort with YPFB in the Altiplano area.

12. The recent discoveries of important gas deposits -- almost all in Bolivian Gulf's concessions -- offer the means to offset a possible leveling-off in oil production. Known gas reserves now are estimated at about 4 trillion cubic feet -- a small amount by world standards -- and are expected to more than double as a result of current exploration. YPFB and Bolivian Gulf already have signed a 20-year contract with Argentina for sales of 140-160 million cubic feet per day at a minimum price of 22½ cents per thousand cubic feet. YPFB is to supply up to half of the gas if it can develop sufficient reserves. The balance of payments would benefit by almost \$7 million annually after allowing for debt service on the planned pipeline and other foreign exchange costs. Argentina's gas requirements soon will exceed twice the contracted amount, and Brazil and Chile are other potential export markets.

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Table 2

Bolivian Exports a/

| Million US \$ | | | | | |
|----------------|--------------|------------|-----------------------|------------------|--------------|
| <u>Year</u> | <u>Total</u> | <u>Tin</u> | <u>Other Minerals</u> | <u>Petroleum</u> | <u>Other</u> |
| 1951 | 150 | 93 | 42 | Negl. | 15 |
| 1960 | 68 | 43 | 17 | 4 | 4 |
| 1961 | 76 | 51 | 18 | 2 | 5 |
| 1962 | 76 | 54 | 16 | 1 | 5 |
| 1963 | 86 | 57 | 23 | 2 | 4 |
| 1964 | 114 | 81 | 27 | 1 | 5 |
| 1965 | 131 | 93 | 31 | 1 | 6 |
| 1966 | 151 | 93 | 38 | 7 | 13 |
| 1967 | 166 | 90 | 41 | 26 | 9 |
| 1968 | 176 | 93 | 46 | 26 | 11 |
| esti- mated | | | | | |

a. The data include freight and costs of smelting metals abroad, which accounted for 13 percent of the total in 1968.

13. Since 1957 the Gulf Oil Company has spent some \$150 million in developing its Bolivian properties. Gulf did not begin to realize a profit from its Bolivian investment until 1967, when the pipeline extension had been completed and there was a full year of production in the Santa Cruz oilfields. Direct investment in Bolivia (reflecting mainly Gulf's operations) averaged \$11 million annually during 1957-65. With the completion of Bolivian Gulf's pipeline, direct investment fell to \$2 million in 1966 and to negligible amounts in 1967-68. In 1967, when oil exports reached \$26 million, profit remittances from Bolivia -- almost entirely by Bolivian Gulf -- rose to \$9 million, and repatriation of depreciation allowances amounted to \$2.5 million. Profit remittances decreased to less than \$7 million in 1968, however, because the company agreed to relinquish its 27 percent depletion allowance. Expected profit remittances of \$9 million and capital depreciation outflow of \$3 million in 1969 probably will be balanced by an inflow of funds for initiation of work on the gas pipeline to Argentina.

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14. Bolivian Gulf's tax arrangements under the 1956 Petroleum Code are favorable compared with those elsewhere in Latin America. Its taxes amounted to \$8 million in 1968, or about 12 percent of the central government's revenues. When gas exports to Argentina are initiated, the company's taxes are expected to rise to at least \$13 million annually.

15. Nationalization of all or part of Bolivian Gulf's properties probably would cause an economic setback for Bolivia, at least for a few years. It would halt the expansion of the oil industry -- the single most important development project -- would damage prospects for other much-needed foreign investment, and would jeopardize a substantial portion of foreign aid. Even if compensation were not paid, Bolivia almost certainly would gain less than the amounts Gulf is repatriating. Production costs probably would rise because of inefficient operation of the oilfields and pipeline, and short-term marketing difficulties would occur because all exported crude oil now goes to California for processing. Nationalization of the gasfields almost certainly would stop construction of the pipeline to Argentina. The World Bank's \$23 million loan for the line is contingent upon the Gulf-YPFB-Argentine agreement, and Gulf's planned investment necessarily would be lost. For a country just beginning its resource development, the long-run loss of foreign investment would be even more serious. Bolivia has not been able to lure much foreign capital under the best of circumstances, and nationalization of Bolivian Gulf would be a further strong deterrent.

Economic Relations with the United States

16. Should Bolivia nationalize US investments without compensation, it also would risk loss of aid from the United States and international financial institutions relying heavily on US funds. These sources still provide most of Bolivia's foreign capital inflow. Gross receipts of capital from them in 1968 totaled some \$62 million -- about \$30 million from the US government and the remainder mainly from the International Development Association and the Inter-American Development Bank. In 1969 these receipts should come to \$70 million.

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Loss of the funds probably would mean a severe cutback in development efforts because Bolivia depends heavily on imports for investment goods. With foreign exchange reserves of only \$30 million, it is in a poor position to pay for capital equipment and intermediate products now being obtained on credit. Deteriorating relations with the United States also could cause consumer difficulties because Bolivia must import three-fourths of its wheat supplies, a large part of which comes in under PL-480.

17. Bolivian Gulf is a small part of the Gulf Oil Company's operations; in 1968 it represented only about 2 percent of its total investment and one-half of one percent of its gross earnings. Gulf Oil probably would be willing to give Bolivia a larger profit share but can be expected to contest a takeover strongly because the operation has just begun to pay off after a decade's expenditure. Even if its gas deposits were nationalized, Gulf might stay on in the oil industry if this appeared to be the best way to recoup its investment. In this event, the company undoubtedly would try to repatriate its investment as quickly as possible and would send no new money into the country. Gulf's investment is not covered under the US investment guaranty program, but the company might seek US government support in negotiations with Bolivia and request application of the Hickenlooper Amendment if dissatisfied.

Conclusions

18. Since the death of President Barrientos in April 1969, a revival of political instability has posed some threats to economic development. The new government led by General Ovando will not necessarily be willing or able to reinstitute the sound policies of the Barrientos administration. Political expediency may bring higher budget deficits, permissive labor policies, accelerated inflation, and disruptive "revolutionary" changes, including moves against foreign firms.

19. The US-owned segment of the petroleum industry, still one of Bolivia's best hopes for economic advance, is the object of nationalistic attacks. During his first two months in office, Siles issued a

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"revolutionary" decree reserving all unleased oil-bearing ground for the state petroleum company and replaced its competent director with a left-leaning nationalist. Not to be outdone, a majority of the Bolivian Senate recently called for uncompensated nationalization of Bolivian Gulf's gas deposits. Ovando is now hinting at nationalization but privately saying he will not nationalize.

20. The economic improvements achieved under Barrientos could easily be undone by weak policies and nationalistic gestures. Expropriation of Bolivian Gulf probably would halt the nation's most important development project, which already has helped to reduce the heavy dependence on tin exports and promises further benefits in foreign exchange earnings and tax revenues as the newly discovered gasfields are exploited. Nationalization of Bolivian Gulf or the other, smaller US companies without just compensation would jeopardize continued aid from the United States and (perhaps) from international financial institutions, which together provided funds equal to two-fifths of export earnings in 1968. Still very poor and badly in need of capital, Bolivia has attracted few foreign investors since the 1952 revolution (when the large tin mines were nationalized) and may now aggravate its economic development problems with nationalistic or otherwise short-sighted policies.

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